What Can We Learn from Past Research about Policies for Small and Informal Firms in Response to COVID-19?

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Policies covered here

- Cash grants (Tsunami, Sri Lanka)
- Wage subsidies (Global Financial Crisis, Mexico)
- Directed credit via private banks (Global Financial Crisis, Brazil)
- Firm formalization (various studies and countries)

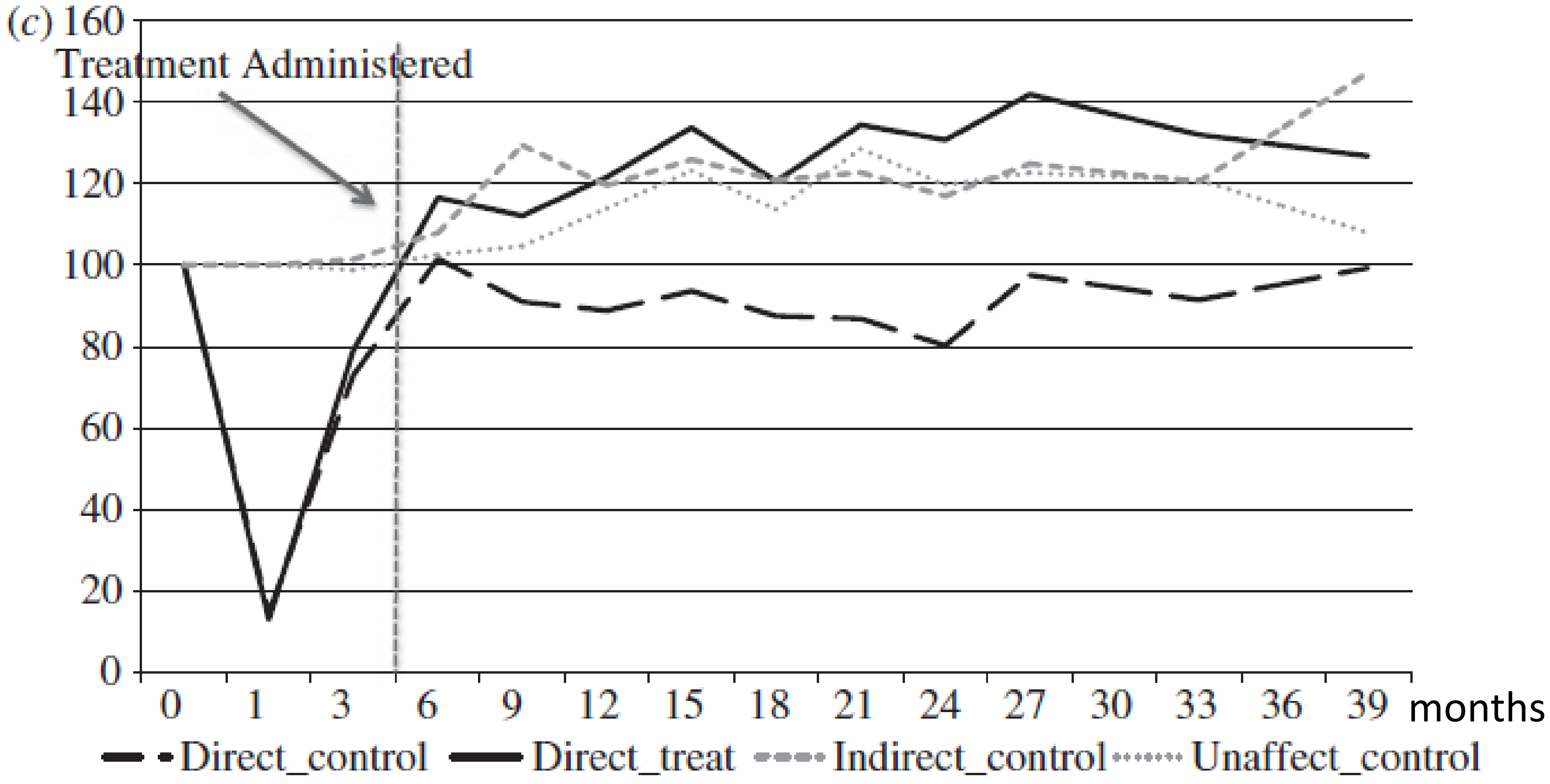
Cash grants: Microenterprise recovery after the December 2004 Indian Ocean Tsunami

De Mel et al. (EJ, 2012)

- Panel survey of 608 microenterprises
  - 11 quarterly rounds 2005-2007
  - 2 semi-annual rounds 2007, 2008
- Three types of firms:
  - Directly affected – assets destroyed
  - Indirectly affected – same neighborhoods, and demand effects, but no damage
  - Unaffected – inland firms
- Experiment randomly gave \$100-200 grants to firms. \$200 is 80% of median pre-tsunami capital stock.

Lesson 1: Business recovery much slower than commonly assumed

- Directly affected firms still haven't caught up 3 years later (e.g. capital stock)



Lesson 2: Access to capital greatly speeds up recovery

- Firms receiving grants recover profit levels almost 2 years before other damaged firms
- On average the grants allowed the damaged firms to recover within the first year, in that damaged firms receiving a grant had profits relative to pre-tsunami size which were almost identical to that of undamaged firms not receiving a grant
- Return to capital is very high: 11.8% per month – and represent a quadrupling of initial grant over a period of less than 2 years

Lesson 3: Capital alone not enough when supply chains are disrupted

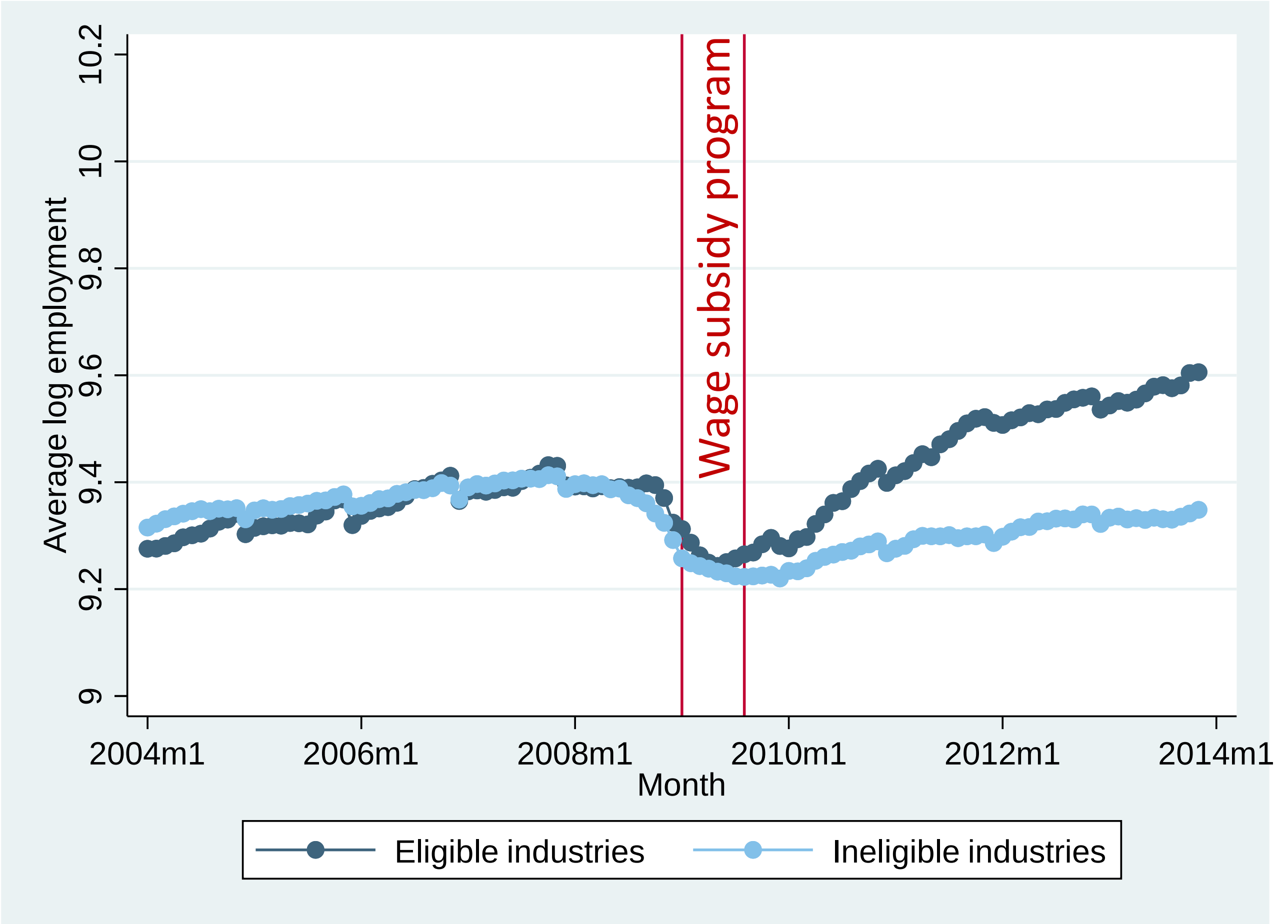
- Grants had much larger impacts in the retail sector than in the manufacturing and services sectors
  - In *retail* – grants led to rapid recovery of capital stocks, and large increases in profits with returns of almost 20% per month
  - In *manufacturing and services* – grant led to recovery in capital stock, but no increase in profits.
- Why?
  - <u>Disruption in supply chains</u> – e.g. firms which are suppliers for a larger manufacturer which is itself disrupted have to wait for it to recover
  - <u>Disruption in trading relationships</u> – e.g. firms who sell to a main buyer lose this customer who finds alternatives while waiting for them to recover
  - <u>Tourism industry recovery takes time</u> – e.g. service firms selling to tourists find demand takes longer to recover than retailers selling to local customers.
  - <u>Retail recovery can benefit from cash aid to households:</u> local demand for retail recovers as cash aid reaches households

Wage subsidy program in Mexico after 2008 Global Financial Crisis

- Firms in durable goods manufacturing industries eligible for receiving wage subsidies from January 2009 to August 2009
  - Conditional on not firing workers and agreeing to reduced work schedules instead
  - Funds were paid out starting in June 2009
- *Bruhn (JDS, forthcoming)* uses industry level social security data and propensity score matching to study effects on employment

Lesson: Subsidies speed up employment recovery

- Employment in eligible industries starts to recover once funds are being paid out
  - Effect seems to come from providing liquidity instead of firing restrictions
- Subsidies also went to large firms, but effects were greater in industries with smaller average firm size



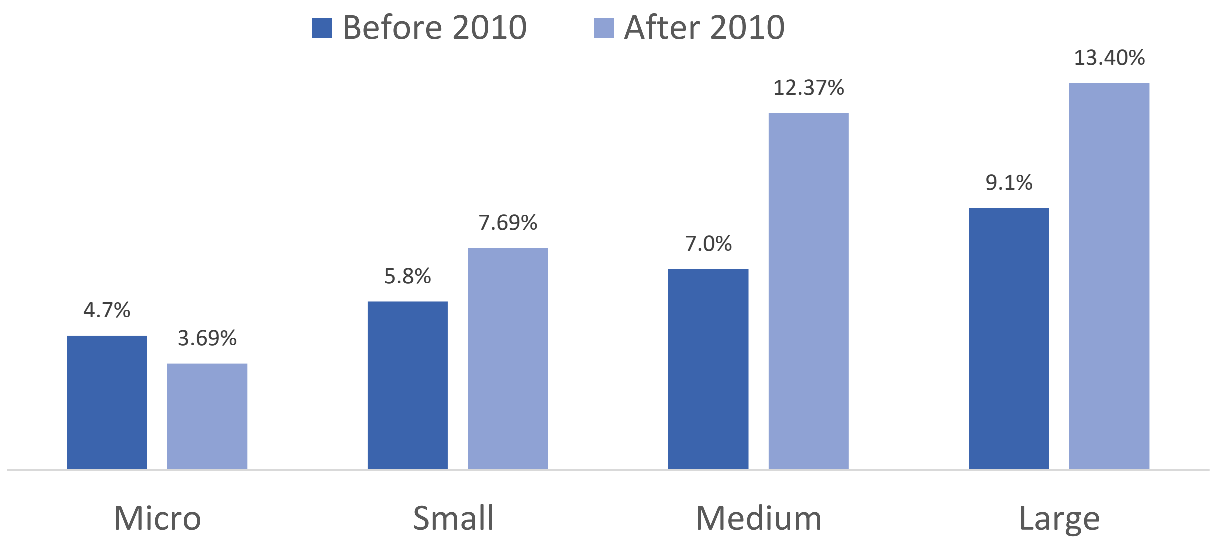
Directed credit via private banks: Earmarked credit program in Brazil

- Program aims to increase credit for constrained firms, with a focus on investment loans
- Brazilian development bank (BNDES) funds commercial banks who select recipients of subsidized interest rate loans
  - Commercial banks carry the risk of loan default → incentives to select borrowers with less default risk
- Large expansion of the program in 2010 (in response to the Global Financial Crisis)

Lesson: Directed credit via private banks may not reach the smallest and most constrained firms

- Earmarked loans mostly go to larger, less credit constrained firms
  - *Haas, Pedraza, Ruiz-Ortega and Silva (2019); Bonomo, Brito, and Martins (2014*)

Share of earmarked credit for the average firm



Micro: < 10 workers Small: >=10 and < 50 workers Medium: >=50 and < 500 workers Large: >=500 workers

Studies on registration of informal firms

- *Bruhn and McKenzie (WBRO, 2014)* summarize lessons from 10 studies in 6 countries
  - Bangladesh, Brazil, Colombia, Mexico, Peru, Sri Lanka

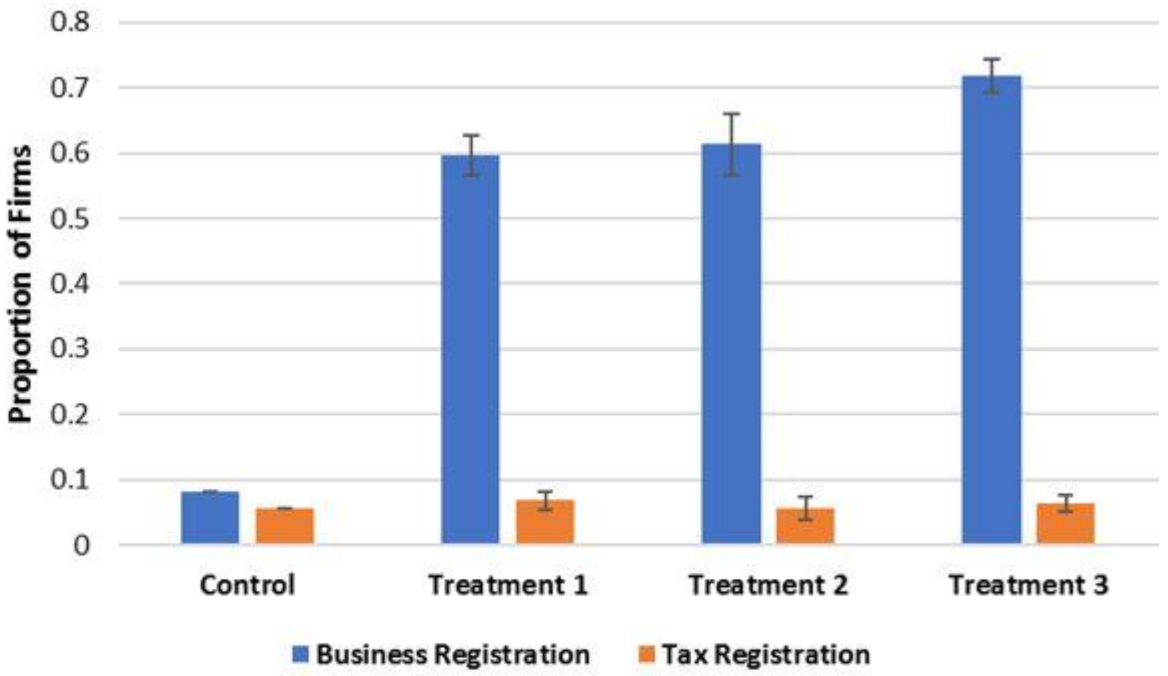
- Benin: *Benhassine, McKenzie, Pouliquen, and Santini (JPubE, 2018)*

- Malawi: *Campos, Goldstein, and McKenzie (2018)*

Lesson: Do not make transfers to informal firms conditional on registering for taxes

- Some type of registry is necessary to identify informal business owners
- Firms are more likely to register when de-linked from tax obligations
- Most informal firms appear to not benefit on net from registering (when registration is linked to paying taxes)

Proportion of informal firms taking-up free cost registration in Malawi



Take-aways

- Cash grants and subsidies speed up firms' recovery
- Directed credit may not reach the smallest firms
- Making transfers to informal firms conditional on tax registration may not benefit firms in the longer run and may limit take-up